STATE OF MICHIGAN

COURT OF APPEALS

FRANK M. POLASKY and FRUMETH H. POLASKY, Petitioners-Appellants, v DEPARTMENT OF TREASURY, Respondent-Appellee.	UNPUBLISHED July 29, 2003 No. 238249 Tax Tribunal LC No. 00-275480

Before: Neff, P.J., and O'Connell and Fort Hood, JJ.

PER CURIAM.

Petitioners Frank M. Polasky and Frumeth H. Polasky appeal by right a Tax Tribunal order affirming respondent Michigan Department of Treasury's tax assessments against them. We affirm.

At issue in this case is respondent's assessment of additional Michigan income tax against petitioners for 1992, 1993, and 1994, following an Internal Revenue Service (IRS) audit of petitioners' tax returns that disallowed federal tax deductions for transactions related to the ownership of an apartment complex. Petitioners appealed the assessments to the Tax Tribunal based on stipulated facts, and the tribunal affirmed the assessments. Petitioners seek reversal of the tribunal's decision, arguing 1) that respondent improperly issued the tax assessments based on the IRS-reported adjustments in petitioners' federal AGI, and 2) that the tribunal erred in concluding that the transactions at issue were not conducted in the course of a trade or business. We conclude that reversal is not warranted on either basis.

I

Petitioner[1] Frank M. Polasky is an experienced tax attorney, who is also a licensed real estate broker and has extensive dealings in real estate. In 1984, petitioner held a twenty percent

[1] This appeal involves petitioner Frank Polasky's treatment of mortgage interest on Schedule C of petitioners' joint federal income tax returns. For ease of reference, we use the term "petitioner" in the singular to refer to Frank Polasky.

ownership interest in the River Oaks Apartment Company (the partnership). In April 1984, the partnership acquired a $3,750,000[2] mortgage loan on an apartment complex known as the River Oaks Apartments (River Oaks). The following month, on May 11, 1984, the partnership sold River Oaks on a land contract. On its tax returns, the partnership reported the net profit from the land contract sale on the installment basis, and reported the mortgage loan interest as investment interest expense and the land contract interest as investment income.

In 1988, petitioner became the sole owner of the assets and liabilities of the partnership. The partnership's assets included a small amount of cash and the River Oaks land contract. After becoming the partnership's sole owner, petitioner began reporting the interest income and expense from the River Oaks land contract and the mortgage loan on his income tax return as income and expense of his trade or business, on a Form 1040 Schedule C, Profit or Loss from a Business.

The dispute in this matter involves petitioner's treatment of River Oaks as business income and expense for tax years 1992, 1993, and 1994, by which petitioner deducted the mortgage interest expense from the interest income received from the land contract payments. In a 1995 audit of petitioners' income tax returns, the IRS examiner concluded that petitioner's treatment of the River Oaks income and expense was improper, and that the land contract interest income should be reported on a Schedule B (Interest and Dividend Income) and the mortgage interest deduction[3] should be reported on Schedule A (Itemized Deductions) as an investment interest deduction. Petitioner disagreed and appealed the IRS examiner's adjustments. For settlement purposes, it was agreed that half the interest income from the land contract and half the mortgage expense would be reported on Schedule C. The remaining half of the interest income would be reported on Schedule B and the remaining mortgage interest expense would be reported as investment interest expense, an itemized deduction, on Schedule A. Petitioners opted not to pursue the matter at the federal level because of the nominal amount of the tax due, $8,826. The adjustments made by the IRS for the disallowed mortgage interest expense increased petitioners' AGI for 1992, 1993 and 1994.

In 1997, petitioner filed amended Michigan tax returns for years 1992, 1993, and 1994. However, petitioner did not make an adjustment reflecting the disallowance of half the mortgage interest as a Schedule C interest expense.[4] After the IRS reported the adjusted AGI to respondent, respondent issued the tax assessments in question, reflecting additional tax owed: $10,469 for 1992, $10,194 for 1993, $10,443 for 1994, plus interest of $6,358.70, $5,471.72, and

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[2] The mortgage note was later increased to $4,875,000.

[3] The claimed mortgage interest for 1992, 1993, and 1994 was $455,160, $443,211, and $453,190, respectively.

[4] Petitioners did, however, attach a note to their amended returns, with a full explanation of their position regarding the treatment of the mortgage interest expense.

$4,838.28 for each respective year.[5] Petitioners appealed the assessments to the Tax Tribunal. In lieu of a hearing, the parties submitted stipulated facts and briefs.

II

Statutory interpretation is a question of law and is reviewed de novo on appeal. *Oakland Co Bd of Co Rd Comm'rs v Michigan Property & Cas Guaranty Ass'n*, 456 Mich 590, 610; 575 NW2d 751 (1998). Generally, this Court defers "to the Tax Tribunal's interpretation of a statute that it is delegated to administer." *Maxitrol Co v Dep't of Treasury*, 217 Mich App 366, 370; 551 NW2d 471 (1996).

"This Court's review of Tax Tribunal decisions is limited to determining whether they are authorized by law and whether the factual findings are supported by competent, material and substantial evidence on the whole record." *Mid America Mgt Corp v Dep't of Treasury*, 153 Mich App 446, 460; 395 NW2d 702 (1986). This Court has held that an agency's decision that is not authorized by law is one that is in violation of statute or constitution, in excess of the statutory authority or jurisdiction of the agency, made upon unlawful procedures resulting in material prejudice, or is arbitrary and capricious. *Northwestern Nat'l Cas Co v Comm'r of Ins*, 231 Mich App 483, 488-489; 586 NW2d 563 (1998).

"Substantial evidence" means more than a scintilla of evidence, but it may be substantially less than a preponderance of evidence. *Mid America*, *supra.* "In general, when a case is submitted to a governmental agency on stipulated facts, as occurred here, those facts are to be taken as conclusive." *Columbia Assoc, LP v Dep't of Treasury*, 250 Mich App 656, 665; 649 NW2d 760 (2002).

A

Petitioner contends the tribunal committed error requiring reversal in failing to apply the two-pronged test outlined in *Comm'r v Groetzinger*, 480 US 23; 107 S Ct 980; 94 L Ed 2d 25 (1987), which, when applied to the stipulated facts, requires a conclusion that the River Oaks transactions were part of petitioner's trade or business. We disagree.

In *Groetzinger*, *id*. at 24, 35, the Court addressed the context of a minimum tax and whether a full time gambler was engaged in a trade or business, as opposed to a hobby. The Court, *id*. at 35, recognized a basic two-part threshold in distinguishing a trade or business from other income or profit producing activity:

> We accept the fact that to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer's

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[5] Although the treatment of interest expense as an itemized deduction rather than a business expense may not significantly affect federal taxable income, apparently the same is not true with respect to Michigan taxable income because Michigan does not allow the subtraction of itemized deductions from the federal AGI to determine state taxable income.

> primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify.

However, the *Groetzinger* Court recognized the difficulty of formulating any single test for determining whether a profit or incoming producing endeavor constitutes a trade or business. *Id*. at 27-34, 36. The Court specifically limited its holding to the circumstances of that case. *Id*. at 27.

Here, the tribunal found that petitioner incorrectly interpreted the Court's holding in *Groetzinger*, *supra* at 35, "as applying to all circumstances," and also misapplied the Court's holding to the very different facts of the instant case. On appeal, petitioner claims the decision in *Groetzinger* "is still good law and is still cited for its test for being in a trade or business, whether or not the taxpayer is a gambler." To support his reliance on *Groetzinger*, petitioner cites *Portland Golf Club v Comm'r of Internal Revenue*, 497 US 154, 156; 110 S Ct 2780; 111 L Ed 2d 126 (1990), where the Supreme Court considered "the circumstances under which a [non-profit] social club, in calculating its liability for federal income tax, may offset losses incurred in selling food and drink to nonmembers against the income realized from its investments." However, Justice Kennedy's cite to *Groetzinger*, *supra* at 27, in his concurring opinion, referred to the profit-making intent implied by the term "trade or business."

The facts of *Portland Golf Club* are inapposite, and the citation to the *Groetzinger* "test" in that case does not mandate a finding of error in the tribunal's conclusion that the *Groetzinger* test alone was insufficient to prove that petitioner was engaged in a trade or activity. As the *Groetzinger* Court noted, each case requires an examination of the particular facts. *Id*. at 36. Regardless, the tribunal further concluded that, even applying the *Groetzinger* test, petitioner failed to show that the River Oaks transactions were trade or business activity.

B

Petitioner contends that the tribunal erred in failing to find that he was not engaged in the trade or business of real estate and real estate financing and that the River Oaks transactions were not transactions in the ordinary course of his businesses. We disagree.

The tribunal concluded that petitioner's River Oaks activities amounted to investment activities rather than a trade or business. Given the stipulated facts and the applicable law, we cannot conclude that the tribunal's decision was not authorized by law. *Northwestern Nat'l Cas Co, supra*; *Mid America Mgt Corp, supra.*

Petitioner asserts that his "long, extensive, continuous and profitable real estate activities more than meet the standards of regularity and continuity set forth in *Groetzinger*, *supra.*" However, the question is not whether petitioner has an extensive history in real estate generally, but whether the River Oaks transactions, in particular, were conducted in the course of a trade or business. The tribunal found unconvincing petitioner's arguments that he has made more money in real estate than law and that petitioner would not risk such indebtedness for a mere hobby. The stipulated facts established that petitioner initially acquired an interest in the River Oaks property through the partnership, which treated the mortgage loan interest as investment interest expense and the land contract interest as investment income. Petitioner's activity from 1984 to

1988 with regard to River Oaks merely involved an increase in his ownership share of the partnership. The mortgage interest expense deducted by petitioner related to the continuing payment of the underlying mortgage negotiated in 1984. We conclude the tribunal's finding that petitioner's River Oaks transactions were investment activities was based on competent, material, and substantial evidence on the whole record. *Mid America Mgt Corp, supra*.

Petitioner cites *Curphey v Comm'r of Internal Revenue*, 73 TC 766, 771 (1980), where the court noted that it had repeatedly held "that the rental of even a single piece of real property for the production of income constitutes a trade or business." We note however, the court also stated it was "not prepared to conclude that, in every case, the ownership and management of [rental] properties would, *as a matter of law*, constitute a trade or business . . . ." *Curphey, supra* at 774 (emphasis in original).

The tribunal found *Curphey* inapposite because petitioner's "activities consisted mainly of buying and selling real property for profit, and did not rise to the level of 'active management' of real property, as the petitioner's activities did in *Curphey*." Thus, the associated expenses were not deductible as paid or incurred in carrying on a trade or business. We find no error in the tribunal's distinction of the circumstances in *Curphey*. Merely because active management of a single property may constitute a trade or business, it does not necessarily follow that the transactions involving the single property in this case constitute a trade or business, particularly where the expenses at issue are not incident to active management, e.g., "supplying furnishings, seeking out new tenants, and cleaning and preparing the rental units for rental."

Our review of the tribunal's decision is limited. *Northwestern Nat'l Cas Co, supra*; *Mid America Mgt Corp, supra*. Petitioner has failed to show which factual findings, if any, fail to meet the substantial evidence test or that the tribunal's decision was not authorized by law.

III

Petitioner argues the tribunal erred by upholding a tax assessment based on an AGI figure that conflicts with the definition of AGI under Michigan law. We disagree.

We have previously recognized respondent's "express authority to audit Michigan tax returns, and that express authority necessarily includes the authority to assess the validity of the federal tax statements upon which Michigan tax computations depend." *Maxitrol Co, supra* at 372. We find although respondent has express authority to assess the validity of the federal tax statements on which it relies, petitioner has provided no authority requiring respondent to validate the federal tax statements.

Under MCL 206.325(2), petitioner was required to file amended tax returns reflecting the changes made by the IRS to petitioner's AGI. It is undisputed that petitioner failed to file amended returns reflecting those changes. Thus, respondent properly relied on the statements it received from the IRS showing petitioner's recalculated AGI.

Under MCL 205.21(1), when a taxpayer fails to make a return, respondent "may obtain information on which to base an assessment of the tax . . . ." Here, respondent relied on petitioner's federal AGI as reported by the IRS, which, at that time, was uncontested by petitioner. Further, the tax tribunal found no basis for disregarding the federal computations.

Petitioner's have failed to show error requiring reversal in the tribunal's decision that respondent could rely on the federal AGI figures to amend petitioners' Michigan income tax.

Affirmed.

/s/ Janet T. Neff
/s/ Peter D. O'Connell
/s/ Karen M. Fort Hood